

INTERNAL REVENUE SERVICE
District Director
2 Cupania Circle
Monterey Park, CA 91754

DEPARTMENT OF THE TREASURY
Western Key District

CERTIFIED

Date: APR 14 1995

Employer Identification Number:

Case Number:

Person to Contact:

Telephone Number:

Refer Reply to:
EP/EO:REV:NJ

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code (Code).

The information submitted with your application shows that you were incorporated under the nonprofit corporation laws of the

Your Articles of Incorporation state that you are, "organized exclusively to carry on any lawful non-profit business or enterprise of a charitable, religious, educational, or scientific purpose, including the making of distributions to organizations that qualify as exempt organizations under a section of any future federal tax code, specifically a public benefit to the community."

FACTS:

You state in your application that you plan to offer a debt reorganization service to people in the in You plan to contact creditors and ask them for a list of their debtors who are having problems making payments on their debts. You plan to contact the debtor and advise them of your services. You also accept walk-in clients and referrals.

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Code	Initiator EP/EO:TS:REV:	Reviewer EP/EO:TS:REV	Reviewer EP/EO:TS	Reviewer EP/EO	Reviewer DO	Reviewer EP/EO:TS:REV
Surname						
Date						

Form 1517 Correspondence Approval and Clearance Department of the Treasury/Internal Revenue Service

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The clients complete a budget and you develop an affordable payment plan which you submit to the creditor for their approval. You advertise that there is no fee to the client/debtor. Creditors are required to pay [redacted] percent of the monthly payments from debtors to your organization. The confirmation letter you send to the creditor states that you will either withhold the [redacted] percent at the time the payment is received or you will bill the creditor at monthly intervals. The creditor is required to sign the agreement and indicate which method they plan to use. You inform the creditor that the [redacted] percent payment is tax-deductible and refer to the payment as a "contribution."

You indicate that this activity constitutes approximately [redacted] of your activities. You list the [redacted] percent payment as your main source of support. You also intend to solicit corporate donations.

ISSUE:

Does the organization qualify for exemption from Federal income tax as an organization described in section 501(c)(3) of the Code?

LAW:

Section 501(c)(3) of the Code describes certain organizations exempt from income tax under section 501(a) and reads in part as follows:

"(3) Corporations, and any community chest, fund, or foundation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on legislation, (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of any candidate for public office."

Section 1.501(c)(3)-1(a) of the Income Tax Regulations (Regs), provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section. An organization that fails to meet either the organizational or the operational test is not exempt.

Section 1.501(c)(3)-1(a)(1) of the Regs provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If any organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the Regs provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes; and (b) do not expressly empower the organization to engage otherwise than an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c) of the Regs. provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it primarily engages in activities which accomplish exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the Regs provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the Regs provides that an organization is not operated exclusively for one or more exempt purposes if the net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(2) of the Regs defines the term "charitable" to include relief of the poor and distressed or of the underprivileged.

Regs Section 1.501(c)(3)-1(d)(1)(ii) states, in part, that an organization is not organized or operated exclusively for one or more exempt purposes "...unless it serves a public rather than a private interest. Thus...it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization or persons controlled, directly or indirectly, by such private interests."

Section 1.501(c)(3)-1(e) of the Regs provides that an organization may meet the requirements of section 501(c)(3) of the code although it operates a trade or business as a substantial part of its activities, if the operation of the trade or business is in furtherance of the organization's exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business.

Section 513 of the Code defines a trade or business as follows:

"For purposes of this section, the term 'trade or business' includes any activity which is carried on for the production of income from the sale of goods or the performance of services.' For purposes of the preceding sentence, an activity does not lose its identity as a trade or business merely because it is carried on within a large aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purpose of the organization. Where an activity carried on for profit constitutes an unrelated trade or business, no part of such trade or business shall be excluded from such classification merely because it does not result in profit."

Trade or business has the same meaning that it has for the purpose of determining whether a particular expense is a deductible trade or business expense under Code section 162 and includes any activity carried on for the production of income from the sale of goods or in the performance of services.

Section 1.502-1 of the Regs states, "... (a) In the case of an organization operated for the primary purpose of carrying on a trade or business for profit, exemption is not allowed under section 501 on the grounds that all profits of such organizations are payable to one or more organizations exempt from taxation under section 501. In determining the primary purpose of an organization, all circumstances must be considered, including the size and extent of the trade or business and the size and extent of those activities of such organization which are specified in the applicable paragraph of section 501."

In the court case, Consumer Credit Counseling Service of Alabama, Inc. et al v. U.S. 44 AFTR 2d 79-5122 (D.D.C. 1978), the court held that an organization composed of 24 consumer counseling agencies whose principal activities constitute free information to the general public through the use of speakers, films and publications, on the subjects of budgeting, buying practices, and the sound use of consumer credit; and counseling on budgeting and the appropriate use of consumer credit to debt-distressed

individuals qualifies for exemption under section 501(c)(3). A nominal fee of not more than \$10 is charged to the debtor. There is no charge to the creditor. Approximately 12 percent of the organization's time is applied to the debt management program. The agencies receive an incidental amount of their revenue from the debt management program. The major source of the agencies' income is provided by government and private foundation grants, and contributions.

In Presbyterian & Reformed Publishing Co. v. C.I.R., 79 T.C. 1070 (1982), the Tax Court found that the manner in which the organization conducted its activities revealed a non-exempt commercial purpose that was substantial in nature. In making this determination, the court noted that where a non-exempt purpose is not an expressed goal of the organization, courts have nonetheless focused on the manner in which the organization conducts its activities, implicitly reasoning that an end can be inferred from the means chosen to attain it. If, for example, an organization's management decisions replicate those of commercial enterprises, it is fair to infer that at least one purpose of the organization is commercial.

The Court found that B.S.W. Group Inc. (1978), 70 T.C. 352, an organization offering consulting services for a fee to exempt or non-profit organizations, would compete with commercial consulting enterprises and was not exempt.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279, 66 S. CT. 112, 90 L. Ed. 67, the Supreme Court of the United States held that the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number of or importance of truly educational purposes.

Revenue Ruling 69-441, 1969-2 C.B. 115, provides that a non-profit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems is exempt under section 501(c)(3) of the Code. The organization provides information to the public on budgeting and the sound use of consumer credit through the use of films, speakers, and publications. It aids low-income people by providing them with individual counseling, and if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily makes fixed payments to the organization. The funds are kept in a trust account and disbursed on a partial payment basis to the creditors. The debtor receives full credit for the amounts paid. The organization's income is from contributions from the creditors

participating in the budget plans. However, the creditors are not required to make contributions as a condition of participation.

Revenue Ruling 69-528, 1969-2 C.B. 127, denied exemption to an organization regularly carrying on investment services that would be unrelated trade or business if carried on by any of the exempt organizations on whose behalf it operates.

Revenue Ruling 70-535, 1970-2 C.B. 117, provides that a non-profit organization formed to manage low and moderate income housing projects for a fee does not qualify for exemption under section 501(c)(3) of the Code. The organization operated in a manner similar to those providing such management services for profit. The fact that these services were being performed for tax-exempt corporations did not change the business nature of the activity.

Revenue Ruling 72-369, 1972-2 C.B. 245, denied exemption to an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations.

ANALYSIS AND CONCLUSION:

All of the preceding Code Sections, Income Tax Regulations, Revenue Rulings and Court Cases describe the criteria under which an organization may be exempt as an educational organization under Code section 501(c)(3), and when an organization is deemed not to be exempt under Code section 501(c)(3).

Your organization is not EXCLUSIVELY Educational as defined in Regs 1.501(c)(3)-1(d)(3). You can be distinguished from the organization described in the above Revenue Ruling 69-411. The organization's income is contributions from the creditors participating in the organization's budget plans. However, the creditors are not required to make contributions as a condition of participation. You require a mandatory percent fee from the participating creditor, which you incorrectly identify as a contribution when in reality, it is a mandatory payment for your services. You are operating in a similar manner to a for-profit collection agency and a management and consulting business. Even though you are performing a charitable activity by assisting low-income individuals with their financial problems, you are conducting this activity in a manner similar to a proprietary business.

You can be distinguished from the organization described in the above court case, Consumer Credit Counseling Service of Alabama. Your debt management or debt reorganization activities

constitute approximately 80 percent of your time and are thus your primary activity. It appears you conduct only a minimal amount of educational activities. You charge creditors a mandatory fee of percent of a debtor's monthly payment as a fee for your services. Neither the application nor subsequent information submitted shows that you receive any grants or funding from any government agencies or private foundations.

Your primary activities are similar to the activities of the organization described in Revenue Rulings 70-535, 72-369 and B.S.W. Group Inc. in that you are essentially engaged in a commercial business activity in order to carry out your charitable activities. You are operating similarly to a collection agency and management and consulting firm. You are securing payments from debtors and remitting them to the respective creditor for a percentage of the payment. Although the services you provide may be beneficial to the community, you are conducting an activity indistinguishable from an ordinary commercial enterprise.

To be considered for tax exempt status under Code section 501(c)(3), an organization must be both organized and operated exclusively for one or more purposes specified in that section. Also, its activities must be restricted to those permitted a Code section 501(c)(3) organization.

It is the position of the Internal Revenue Service, based on the information submitted, that you are not entitled to exemption from Federal income tax as an organization described in Code section 501(c)(3), inasmuch as you are not organized or operated exclusively for the purpose specified in that Code section.

If you are in agreement with this proposed determination, we recommend that you sign and return the enclosed agreement, Form 6018. Please note the instructions for signing on the reverse side of the form.

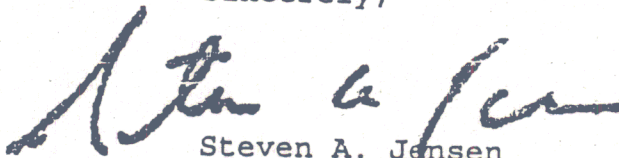
If you are not in agreement with this proposed determination, we recommend that you request a hearing with our office of Regional Director of Appeals. Your request for a hearing should include a written appeal giving the facts, law, and any other information to support your position as explained in the enclosed Publication 892. You will then be contacted to arrange for a hearing. The hearing may be held at the office of Regional Director of Appeals, or if you request, at a mutually convenient District office.

If we do not hear from you within 30 days from the date of this letter, it will be considered by the Internal Revenue Service

as a failure to exhaust available administrative remedies and will then become our final determination. Section 7428(b)(2) of the Internal Revenue Code provides in part that, "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Court of Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service."

If you have any questions, please contact the person whose name appears on the heading of this letter.

Sincerely,

A handwritten signature in dark ink, appearing to read "Steven A. Jensen", is written over the typed name.

Steven A. Jensen
District Director

Enclosures:
Publication 892